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"I'd rather be small and profitable than big and stupid," CEO Andy Kershner says of his namesake trading group, which operates out of this North Austin office space as well as in Shanghai, China. Kershner Trading had a record 2008, he says, but is heavily invested in its financial software.

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## Kershner Trading finds profits in market volatility

By **Kirk Ladendorf**  
AMERICAN-STATESMAN STAFF

Sunday, April 19, 2009

In 2001, when he was 32, Andy Kershner and three partners sold an Austin securities trading company for \$150 million.

Now, eight years later, Kershner heads another expanding securities trading business with a growing trading floor in Austin and a fledgling operation in Shanghai, China.

Kershner Trading Group does not disclose its financial results, but Kershner said the company had a record year in 2008, with more than \$50 million in revenue from profitable stock and options trades.

It wasn't the only one. Experts say more than 100 proprietary trading companies, or "prop shops," operate around the country and a number of them reported strong profits last year.

"Proprietary trading desks are short-term traders, and they thrive on volatility," said Kumar Venkataraman, a finance professor at Southern Methodist University's Cox School of Business. "In the last year or so, the volatility has been tremendous."

This year has gotten off to a slower start, Kershner says. The company is still making profitable trades but is not profitable overall because of heavy investment in financial software to support its trading activity.

Kershner is proud of his company's success, but he's well aware that millions of investors lost trillions of dollars last year as investment securities plummeted worldwide.

"You have to be careful of how much you talk about it," he said. "Everybody else is having tough times. You feel a little bit guilty about it when everybody else is losing money."

He's also aware that Wall Street is in disrepute right now. Many of the giants of the financial industry are bankrupt or propped up with federal bailout dollars after losing enormous wagers on mortgage-backed securities.

Compared with the giants, Kershner's operation is minuscule.

"I'd rather be small and profitable than big and stupid," he said.

The company's trading room in North Austin hardly resembles Wall Street.

The 140 traders dress primarily in jeans and T-shirts and work with the intense focus of avid computer gamers — which many of them are. They use the company's market scanning software to rapidly spot favorable patterns for trading individual stocks. The software, which uses specialized algorithms, sends out a stream of recommended stock trades. The traders then use the company's software to execute trades within seconds. Many times they buy and sell stocks within minutes.

Floor managers monitor the traders closely, gauging the amount of company capital that is at risk in any given minute. Any individual employee's trading limit can vary from day to day, depending on recent success, or lack of it.

'Introverted gamers'

The traders are mostly in their 20s and early 30s, 95 percent male

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and incredibly focused.

"It is introverted gamers," said trader Daniel Rodriguez, surveying his peer group. "Those tend to be more of the better traders.

"Some of it is keyboard skills. You have to have your hands be able to execute a trade without thinking about it much. If you take too much time to execute, it is over," meaning that the opportunity can evaporate as traders with faster reflexes move in.

The prop shops have expanded with the rise of more sophisticated software and electronic networks, Venkataraman said. Giant Wall Street firms used to dominate stock trading in the U.S., but now New York-based traders with seats on the securities exchanges account for only about 30 percent of all New York Stock Exchange trading, the professor said.

Some of the proprietary firms fit stereotypes of day-trading companies, which charge amateur traders to gain access to securities trading software.

Kershner does it differently. Its traders put only the company's money to work, and they don't earn a salary. Instead, they share their investment profits with the company. If they aren't making any money in the market, then they literally are not making money. Some beginning traders have second jobs so they can pay the rent.

The company plans to recruit about 80 traders in Austin and a similar number in Shanghai this year.

Many of the new traders are just out of school. Most have not traded professionally before. Training rookies takes time, Kershner says, but it also means that they follow the company's trading discipline and don't acquire too many bad habits, including making too many risky trades.

The company provides continuous coaching and supplies customized software tools to help traders spot more potentially profitable trades and quickly execute and track them.

"We are applying technology in interesting ways to create jobs and get an edge in the marketplace," Kershner said. "We were pretty fortunate last year. Whatever the market gives us, we will do our best to try to capitalize on it."

From geology to stocks

Kershner's own career in stock trading started almost by accident.

He grew up in Houston before attending Vanderbilt University, where he graduated in 1990 with a degree in geology. He spent much of the next four years traveling around the country, working as a ski instructor and surfing in Maui for several months. He worked as a geologist for a year and hated it, he said.

In early 1994, Kershner landed in Lubbock, where a friend, Scott Dyer, had devised a promising method of trading stocks. Dyer still works as a trader at Kershner.

They spent most of the summer in the Texas Tech University library, tracking the stock market and rushing to the library's pay phone to place orders. Kershner says they lost about two-thirds of their original \$5,000 stake.

Their strategy seemed to work, but they couldn't execute trades quickly enough or at low cost. So they moved to Austin to take their strategy to some of the day-trading companies that had begun operations here.

Kershner began trading aggressively at one day-trading company. He moved to Austin-based Cornerstone Securities in 1996 to do larger trades.

His trading success convinced Cornerstone's partners to let him buy into a partnership in the company in 1998.

David Jamail, one of the partners, remembers being struck by Kershner's acumen.

"He could buy 100 stocks in 30 minutes and turn around and tell you what stocks he bought," Jamail recalled. "He had an unusual ability to evaluate the risk-versus-reward of a transaction very quickly."

The two most important things in investing, Jamail said, is what to bet on and how much. "That is where the art is. The whole idea of evaluating risk and reward and being able to pull the trigger at video-game speed — that is Andy Kershner."

In 1998, Cornerstone developed an advanced software platform, called Gr8Trade, to manage its far-flung trading operation.

The following year, the company was renamed ProTrader Securities Corp.

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#### Retooling its trades

Two years after that, most of the Austin company was sold to Instinet Group Inc. for \$150 million in stock and cash. Instinet primarily wanted the company's trading software.

Before the sale closed, ProTrader's stock trading operations were spun off as Zone Trading Partners LLC, owned entirely by Kershner, who had bought out his partners' interests.

ProTrader was a retail day trading company. Zone Trading, which became Kershner Trading Group in 2006, would trade only with its own money.

In its best year in the 1990s, ProTrader made a profit of about \$11 million, largely from fees and commissions it charged traders. But its clients made more than \$260 million, Kershner said.

A former ProTrader partner, Russell Grigsby, sued Kershner and three other partners in the company. Grigsby claimed the partners unfairly froze him out of the company and forced him to sell his interest without receiving a share of the proceeds from the Instinet sale. An arbitrator awarded Grigsby \$43 million in 2004.

Kershner and his partners then sued their law firm, Vinson & Elkins, claiming it committed legal malpractice when it advised them that Grigsby had no claim to share in the proceeds of the sale. The suit was settled for an undisclosed amount in 2005.

Grigsby said his lawsuit was simply a way to settle a disagreement about how much his stake in ProTrader was worth.

Kershner prefers not to talk much about the lawsuits. "I pretty much put all that behind me, and I don't wish anyone ill will," he said.

Along the way, the new company reacquired its Gr8Trade software at a bargain price and rehired the technical team that had developed the software. In 2007, Kershner bought Insight Trading Software, to substantially bolster its market screening capabilities to quickly spot trading opportunities.

By Kershner's reckoning, few trading companies invest so heavily in developing their own software trading tools.

Better software, he said, makes the company's traders more productive and better able to recognize and execute profitable trades.

"I like what we have, and I think it gives us a leg up," he said.

If he can build a trading company and the supporting software that helps make it a success, a buyer may want to make an offer for the company someday.

"If we build the best mousetrap, other people will want it. It is kind of a hidden value we have. But we don't have any hidden plan to sell it. The idea is, let's build a great business and develop great traders and give them great technology, and if we can do that, good things will come."

Last year, Kershner moved his wife and three sons to Shanghai and founded Kershner Consulting Ltd., where he will try to re-create the Austin operation in the Far East.

#### Why China?

There are personal and business reasons, Kershner says: He wanted to expose his sons to another culture while they were growing up, and he figures the Shanghai investment scene will grow enormously over the next two decades, while U.S. markets slow down. "So we need to be where the action is," he said. "If the U.S. markets get slow, our guys can trade over in Asia.

You want to be where the wind is at your back.

"I could be wrong. I am 53 percent right for the next five minutes," he said, laughing. "I am sure I am right, but I could change my mind tomorrow. It is a little bit of the trader's mentality."

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**Andy Kershner** wrote:

I am a bit embarrassed to be the focal point in this story about Kershner Trading Group. The only reason that we have the opportunity to be recognized in the Statesman is due to the 250ish wonderful people in our two offices. Our traders and technologist are disciplined and work hard to achieve greatness. Our support people dedicate their efforts in service of others success. Please allow me to publicly thank each and every one of you. I appreciate the opportunity to grow our careers together. Times are getting tough out there in the US. Our company is not immune to the environment. Like every company we have serious challenges. I believe that we can work our way through whatever issues that we face together, as a company, as a community, and as a nation. I am excited about the possibilities. Let us set long term goals. Let us be both teachers and students. Let us be disciplined and adaptable. To the future, Andy Kershner

Posted on 4/19/2009 10:40:59 AM

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